SUPREME COURT
OF THE
UNITED STATES

OCTOBER TERM, 1947

No._____

CHICAGO MINES COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE LONDON EXTENSION MINING COMPANY,
as Transferee of CHICAGO MINES COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE LONDON EXTENSION MINING COMPANY,
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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The Petition of Chicago Mines Company, The London Extension Mining Company as transferee of Chicago Mines Company, and The London Extension Mining Company, Colorado corporations, respectfully shows:

SUMMARY AND SHORT STATEMENT OF MATTER INVOLVED.

The petitioners sued in The Tax Court of the United States for a redetermination that would allow percentage depletion deductions from gross income that came from the sale of ores milled and marketed from the dump at their American Mine in Park County, Colorado. The Tax Court ruled in favor of the respondent (R. 9-21; 7 T. C. 1103). On a review by the Circuit Court of Appeals for the Tenth Circuit, the decisions of the Tax Court were affirmed (R. 61-66; 164 Fed. (2d) 785, adv. sheets of Feb. 9, 1948). The present proceeding seeks a review and reversal thereof by this court.

Contrary to the Congressional intention of Sections 23 (m) and 114 (b) (4) of the Internal Revenue Code, Title 26, USCA, the lower court in effect denied the petitioners the right to have a percentage depletion deduction on income from the sale of ores from the mine because such ores had been deposited on the dump at the mine before being hauled to mill and market.

The decision of the court below is contrary to decisions of the Circuit Court of Appeals, 9th Circuit, construing the same sections, in *New Idria Quicksilver Mining Company* v. *Commissioner,* 144 Fed. (2d) 918, and *Commissioner v. Kennedy M. & M. Co.,* 125 Fed. (2d) 388, affirming *Kennedy M. & M. Co.* v. *Commissioner,* 43 BTA 617.

The decision below is also at variance with principles laid down in the recent decisions of this court in *Kirby Petroleum Company* v. *Commissioner* (1946), 326 U. S. 599,

66 S. Ct. 409, 90 L. Ed. 343; *Douglas* v. *Commissioner* (1944), 322 U. S. 275, 64 S. Ct. 988, 88 L. Ed. 1271, and *Herring* v. *Commissioner* (1934), 293 U. S. 322, 55 S. Ct. 179, 79 L. Ed. 389, on the question of an economic interest in mineral property sufficient to support a percentage depletion allowance.

JURISDICTIONAL STATEMENT

The jurisdiction of this court to review the decision of the United States Circuit Court of Appeals, Tenth Circuit, is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Title 28 U.S.C.A, Section 347 (a), for the following special and important reasons:

(a) The Circuit Court of Appeals by its decision herein has rendered a decision in conflict with the decisions of the Circuit Court of Appeals, Ninth Circuit, in the *New Idria* and *Kennedy* cases, *supra,* on the same question or matter.

(b) The lower court has decided an important question of federal law which has not been, but should be, settled by this court. The application to mine-dump ores of Sections 23 (m) and 114 (b) (4), I.R.C., has not yet been considered or decided by this court.

(c) The court below by its decision herein has decided an important federal question in a way in conflict with applicable decisions of this court in *Kirby Petroleum Company* v. *Commissioner* (1946), *supra, Douglas* v. *Commissioner* (1944), *supra,* and *Herring* v. *Commissioner* (1934), *supra.*

(d) The record presents an important federal question involving the Internal Revenue Code and the legislative policy regarding the production of metals, pertaining to the national interest, which should be reviewed and decided by this court.

(e) The lower court has approved the levy of a federal income tax on capital rather than income, in a manner

contrary to the legislative intention, by denying the right to a depletion deduction allowed for the wasting of a capital asset in the form of a metal mine and natural deposit.

OPINION OF THE COURT BELOW

The case on appeal was heard by Judges Bratton, Huxman and Murrah. The opinion appears at R. 61-66 and is reported in 164 Fed. (2d) 785, advance sheets of February 9, 1948. In apt time, on November 26, 1947, the petitioners filed their petition for rehearing and brief in support thereof (R. 71-80), which petition was denied on January 8, 1948 (R. 125).

QUESTIONS PRESENTED

The questions presented involve the following points raised by the taxpayer:

1. London Extension as fee owner and operator, or as fee owner and lessor of the mine retaining a royalty interest, is entitled to its percentage depletion deduction on income in the taxable year, from ores that had been dug from the mine, regardless of whether they were sold immediately on extraction from the veins or were held for a time on the surface of the mine.

2. London Extension had an indisputable economic interest in the mine, its surface and underground deposits, being a half-owner of all thereof; therefore its right to the depletion allowance was clear, whether it sold dump ores itself, as in C. C. A. No. 3510, or whether it sold them and derived income through its lessee, as in C. C. A. Nos. 3508 and 3509.

3. The true and rational meaning of Sections 23 (m) and 114 (b) is that, where an owner of a mine and its underground deposits causes ore therefrom to be processed and marketed by lessee, the owner does not lose his depletion allowance by the circumstance that the particular lease happens to cover only the dump; because the dump ores came from his mine and were still on the property,

and no depletion has been, or could have been, previously allowed because of the mere breaking out and hoisting of such ores to the surface dump.

4. Only an unjust construction can deprive both owner and lessee of all depletion deduction, simply because the lease in Nos. 3508 and 3509 included the dump and not also the underground mine.

5. Section 23 (m) intends that when the owner and lessor of a mine is afforded a deduction for percentage depletion, such deduction is to be shared with whatever lessee may do the work. This is the intent even in a conventional arms-length relationship of lessor and lessee, where there is not the identity between them that existed at bar. The question of depletion *vel non* is answered in the affirmative if the lessor is an owner of the mine and natural deposit.

6. In C. C. A. Nos. 3508 and 3509, London Extension as transferee, and Chicago Mines Co. (nominally lessee but actually an instrument and *alias* of London Extension, its sole owner and parent) are entitled to deduct percentage depletion in respect to income accrued during the taxable period from ore theretofore placed on the dump from prior working of the mine by the lessee of London Extension.

7. Even if the foregoing points were not well taken in C.C.A. Nos. 3508 and 3509, Chicago Mines Company during its existence and operation, although technically a corporation without a leasehold on the underground deposit, was wholly owned by the mine-owner London Extension, and the real interest was identical. Chicago Mines was an instrument and department of London Extension to work and sell dump ores that came from its mine (R. 8, 48). The mine-owner in fact was measuring the depletion of its mine and natural deposit through the operations of its department Chicago Mines, and the depletion allowance should not be forfeited merely because the lease from the mine-owner to its instrumentality or department embraced only the dump. This situation calls for "a reasonable allowance for depletion * * * according to the

peculiar conditions in each case," prescribed by Section 23 (m); and presents also "a form of legal relationship" under Regulations 103, Sec. 19.23 (m) -1 (as amended by T.D. 5210 Jan. 8, 1943).

8. In C.C.A. No. 3510, London Extension is clearly entitled to deduct percentage depletion in respect of income it derived during the taxable period from its own extraction, sorting, milling and sale of ore *from the dump*, and from the *royalties* it received from Chicago Mines Company.

9. Also in No. 3510, the owner London Extension is clearly entitled to the depletion allowance on income from its own mining of ore *from the underground veins*, its gross income being enhanced in the taxable period by its own working and sale of the dump ores and by its retained or reserved royalties from Chicago Mines Company on the dump ores the latter had worked and sold as lessee; this entire income thus necessarily coming from the mine.

10. Further, the dump ores, as well as the ore newly mined from its underground veins, from which London Extension derived part of its gross income during the taxable period, were all ores from its mine, and the income constituted part of its gross income during the taxable period from a single mining property for purpose of measuring the amount of percentage depletion to which it is entitled. Sec. 114 (b) (4) (A) and (B), and Reg. 103, Sec. 19.23 (m)-1 (b) and (i).

> "Income derived from the ores called tailings, as well as that derived from the newly mined ores, *was income from the mine.*"
>
> *Commissioner* v. *Kennedy M. & M. Co.*, 9th Cir., *supra.*

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

(a) The lower court has construed the Internal Revenue Code, Sections 23 (m) and 114 (b) (4), contrary to decisions of the Ninth Circuit, to-wit:

New Idria Q. M. Co. v. *Commissioner,* 144 Fed. (2d) 918, 921.

Commissioner v. *Kennedy M. & M. Co.,* 125 Fed. (2d) 339, 400, affirming *Kennedy M. & M. Co.* v. *Commissioner,* 43 B.T.A. 617.

(b) The lower court has also construed and applied said sections contrary to the decisions of this Court on the economic interests of taxpayers in a natural deposit subject to depletion.

Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 66 S. Ct. 409, 90 L. Ed. 343.

Herring v. *Commissioner,* 293 U.S. 322, 55 S. Ct. 179, 79 L. Ed. 389.

Douglas v. *Commissioner,* 322 U.S. 275, 64 S. Ct. 998, 88 L. Ed. 1271.

(c) The decisions of the lower court, and of the Tax Court therein affirmed, have upset and thrown doubt upon the Ninth Circuit decisions cited above that seemed to settle a question very important to the mining industry, all to the discouragement and jeopardy of the important output coming from mine dumps, which dumps contribute greatly to the national supply of metals.

(d) The decisions and opinion below (R. 61, 64-66) introduce new elements and conditions as tests of the right of a mine-owner to have depletion deduction. These tests are not found in the statute or in previous rulings, and are against the prior decisions cited above. Said further tests and conditions announced below are:

(1) That the marketing of dump ore must be "an integrated part of the orginal mining operation" (R. 64); or "an integrated step in a mining operation" (R. 65); and

(2) That the dump must [illegible]eated with the accompanying intent to wor[illegible] at a future time" (R. 66).

These are novel criteria, without definition, and are contrary to the Ninth Circuit decisions. The new phrases quoted have never been weighed, considered or defined, or their oppressive or unworkable implications explored, in reference to depletion of mines, and they introduce confusing restrictions, against the statutory intent and policy.

PRAYER.

Wherefore your petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals, Tenth Circuit, commanding said court to certify and send to this Court the transcript of record in the above-entitled consolidated cause No. 3508, 3509 and 3510 therein, and that the record and judgments of said court be considered and reviewed according to the rules and practice of this Honorable Court, to the end that said cause may be reviewed and determined, and that the judgment of the United States Circuit Court of Appeals, Tenth Circuit, be reversed, and the cause remanded for further proceedings according to law, and that your petitioner have such other and further relief as may to this Court seem just and proper in the premises.

CHICAGO MINES COMPANY, THE LONDON EXTENSION MINING COMPANY, as Transferee of CHICAGO MINES COMPANY, and THE LONDON EXTENSION MINING COMPANY, Petitioners,

by FRAZER ARNOLD,
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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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OPINION OF THE COURT BELOW

The opinion of the Circuit Court of Appeals, Tenth Circuit, dated November 6, 1947, is reported in 164 Fed. (2d) 785, Advance Sheets of February 9, 1948, and may also be found in the record commencing at page 61.

GROUNDS ON WHICH JURISDICTION OF SUPREME COURT OF THE UNITED STATES IS INVOKED

The judgments of the Circuit Court of Appeals, Tenth Circuit, were entered on November 6, 1947 (R. 67-8). Petition for rehearing was denied on January 8, 1948 (R. 125). Petition for writ of certiorari, *supra*.

The judgment of the lower court is based on its construction of the Federal Internal Revenue Code, Title 26, U.S.C.A., Sections 23 (m) and 114 (b) (4) set forth in the Appendix, *infra*. The jurisdiction of the Supreme Court of the United States is invoked under Sec. 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Title 28, U.S.C.A., Sec. 347 (a).

STATEMENT OF THE CASE.

This proceeding was instituted by petitions in the Tax Court of the United States (R. 1, 29, 42) for a redetermination of the respective deficiencies asserted by the Commissioner of Internal Revenue in his notices of deficiency (see agreements for entry of decisions under Rule 50, R. 22-24, 37, 53-55). The Tax Court held for respondent in the consolidated case on November 7, 1946 (Opinion, R. 9-21), and petitions for review were duly filed in the lower court (R. 25, 37 and 55), resulting in judgments affirming the Tax Court. Petition for Rehearing (R. 69-75) being denied, mandate issued in accordance with the opinion and judgments (R. 125).

The depletion allowance in dispute concerns income derived through sale of ores from the mine dump extending from the collar of the shaft of the American Mine. The petitioner The London Mining Extension Company at all times owned an undivided half interest in the mine (R. 47-8). On June 7, 1940, it had also obtained by assignments all leasehold rights of the previous lessees on the entire ownership (R. 48). The mine consists of the surface and underground workings in the American, Huron, Fraction and Ibex lode mining claims (R. 47-48), shown on the map (R. 51). The other half-interest in the American claim was and is owned by a group called the Ellis heirs, while the other half-owner of the Huron, Fraction and Ibex was and is The London Mines & Milling Company, a corporation having no interrelationship with the petitioner London Extension (R.47). The dump was roughly triangular in shape, extending south from the collar of the shaft near the south corner of the American claim, and lay partially on the American, Huron and Fraction, mostly on the Fraction (R. 48, 51). It had been built up entirely of material from this mine, by underground operations of the former lessees of London Extension and the other co-owners of the mine. (R. 48).

Chicago Mines Company, the wholly owned and held subsidiary of London Extension, was lessee of London Extension to extract and market dump ores from June 10 to October 8, 1940 (R. 48), the income from which operation is involved in C.C.A. No. 3508 and 3509 (R. 7, 8), under a lease dated June 10, 1940 (R. 48). Later all its corporate assets were transferred to its parent company London Extension, and the capital stock held by the parent company and the qualifying shares held by its directors were at that time canceled and surrendered (R. 8, 48). From October 8, 1940 to the end of 1940, the owner London Extension derived further income by its own sale of dump ores which it extracted itself from the dump, while at the same time working underground; this income being involved in C.C.A. No. 3510 (R. 48, 49).

As the result of these operations and income Chicago Mines and its parent company as transferee (London Ex-

tension, the mine-owner) claimed a percentage depletion deduction of $10,150.34, the amount and computation not being disputed (R. 8.), in C.C.A. Nos. 3508 and 3509. And in No. 3510, London Extension claimed depletion, based on its receipt of net smelter returns from its own dump operations during 1940 of $57,014.58, after deducting its marketing and transportation costs; it also claimed the depletion deduction on $16,917.23 royalties from the Chicago Mines dump operations; and further on $22,638.45 net smelter returns from its own underground mining; whereby, in No. 3510, it claims $14,485.54 disallowed depletion (i.e. underground operations $3,395.77, its own dump operations $8,552.19, and dump ore royalties $2,537.58), all undisputed as to computation if allowable (R. 48-49).

SPECIFICATION OF ERRORS

The United States Circuit Court of Appeals, Tenth Circuit, erred:

1. In drawing an artificial distinction, in all three decisions, between ores that had been previously mined and held on the dump and newly mined ores, contrary to Sec. 23 (m) and Sec. 114 (b) (4) (A) and (B).

2. In denying a deduction in C.C.A. Nos. 3508-9, even though Chicago Mines be considered as an ordinary arms-length lessee of the owner, contrary to Sec. 114 (b) (4) (A), which provides that "the allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines * * * 15 per centum * * of the gross income *from the property* during the taxable year * * *."

3. In failing to allow the deduction "according to the peculiar conditions in each case," as enjoined in Sec. 23 (m).

4. In counteracting, in Nos. 3508-9, the broad purpose and policy of this legislation, which is to encourage production of metals as well as to allow mine owners a just depletion. The real and only party in interest in this arrangement called a lease (R. 4, Exhibit B), was the mine owner and taxpayer London Extension. As between the mine owner

and its wholly owned subsidiary and operating department Chicago Mines, corporate entities should be disregarded, because the legislative policy to stimulate output of metals is thereby furthered (authorities, *infra.*)

5. In failing to apply the principle, in Nos. 3508-9 and 3510 alike, that income tax is a levy on income and not on capital, and that, where capital was used up in producing income, the depletion deduction was intended.

6. In considering, in No. 3510, that *two separate properties* were involved, one consisting of newly mined ores, and the other of ores previously mined but held on the ground. Hence the erroneous disregard of the fact that income during the taxable year in the combined form of royalties reserved on dump ores, of income from the taxpayer's own dump operations, and of income from its own underground operations, all was income derived from the one mine and natural deposit.

ARGUMENT.

I.

Percentage depletion deductions apply to income from ores dug from a mine, whether the ores are sold immediately or are held for a time on the surface of the property.

The court below drew a complex distinction out of line with reality in mining operations, between income from the marketing of ores newly mined from the veins and of ores that have been piled for a time on the claims. All the dumped metal had come from the one mine. No depletion on income from it had ever been taken or deducted before, nor could it have been previously deducted, in the very nature of percentage depletion allowances, which must await sale and income for their determination. This error is in direct conflict with the realistic, just and practical Ninth Circuit decisions in the *New Idria* and *Kennedy* cases, *supra,* which are hereinafter quoted.

The rulings below were also contrary to broad and liberal principles recently announced by this court, in reference to an economic interest subject to depletion.

Kirby Petroleum Company v. *Commissioner, supra* (1946).

Douglas v. Commissioner, supra (1944),

Herring v. *Commissioner, supra* (1934).

There can be no distinction in substance between dump ores that have been hoisted and dumped on the surface, and the similar broken stope-fill ores that have remained below. The sole difference is that the former are lying in daylight near the top of the shaft, whereas the stope-fill material is piled in darkness underground. It could not be seriously claimed that a delay of a few years or months in hoisting stope-fill ores to the surface and selling them would deprive the owner and his lessee of their depletion allowance. There would be no sounder basis for assuming a present intention to later mill and sell stope-fill than for denying such intention regarding ores placed on a surface dump. In either case, the "present intention" may be only a hope or belief that future conditions, local or general, will sooner or later make milling and sale profitable. But the unalterable fact is that, whenever such ores are sold, and regardless of what may have been supposed about them before, the income therefrom *does* furnish the basis for measuring the statutory percentage depletion and for ascertaining for the first time the depletion that took place in the mine.

II.

Under Sec. 23 (m) and Sec. 114 (b), Chicago Mines and London Extension as transferee are entitled to depletion allowance as lessee, to be equitably apportioned with London Extension as lessor.

When the owner whose mine is depleted selects a lessee as his instrument on the property to extract and market the ore, Section 23 (m) intends that the depletion deduc-

tion shall be apportioned equitably between owner and lessee. It is a clear legislative declaration that when the mine owner becomes entitled to depletion allowance, his deduction is to be shared with whatever lessee may do the work. Sec. 114 (b) (4) (A) authorizes an allowance for depletion of 15% of the gross income from the property, excluding from such gross income an amount equal to royalties paid by the taxpayer in respect of the property. This deduction is limited in amount so as not to exceed 50% of the net income from the property. Where a mining property is leased subject to a royalty to the owner, the lessee deducts from his gross income the royalty paid to the lessor, and the lessee calculates his 15% depletion allowance on the remainder of gross income. The lessor is entitled to deduct 15% of the royalty received by him. Together, then, the lessor and lessee cannot receive more than 15% of the gross income from the property. Such is the apportionment here claimed by the lessee Chicago Mines and the lessor London Extension on the operations of Chicago Mines in C.C.A. Nos. 3508-9. All ore in the dump came from the American Mine. The petitioner London Extension is admittedly the half-owner of the mine, but the respondent and lower court have denied this owner any allowance for the manifest depletion of its mine, merely because its lessee was employed in extracting and marketing ores from the dump and not also and at the same time ores being broken from the veins. So, by these unnatural and unreal refinements, the owner would forfeit its share of the depletion allowance, and so also would its lessee forfeit its share of the deduction, contrary to the statutory scheme and prior decisions. The mine has obviously been depleted, yet both the owner and its lessee which performed the work lose all their depletion allowance by a kind of sleight of hand, despite the fact of depletion in the mine.

This unjust result was reached below because the lease to Chicago Mines covered only the dump and not the underground deposits, and it was held that, although London Extension's underground deposits were depleted and the depletion now measured for the first time by sale of ore and consequent income, said owner must lose its depletion

allowance because of the circumstance that its lessee was engaged only in recovering ores from the dump. We submit that this is an unjust "distinction without a difference." It is against the intention of Congress, which is to allow mine owners a percentage deduction for the depletion of their capital assets. The deduction is to be equitably shared with the lessee doing the work. This is a feature assisting the owner as well as the lessee, because it enables the owner to offer better terms and induce a lessee to undertake operations, and it directly encourages mining activity and the output of metals, which was the underlying policy and intent of Congress. The legislative policy was also fundamentally just and equitable. In allowing percentage depletion Congress permitted mine owners and operators, engaged in production from a wasting asset, to have a deduction from gross income in compensation for the capital loss to the owner incurred by gradual exhaustion of the deposits on which they are working. In short, the income tax is a levy on income and not on capital; and where, in producing the income, capital was used up, some deduction should be allowed. There can be no difference between this principle as applied to ore in the veins, and ore in the dump from those veins, which has not yet been converted into income. The operator is exhausting the owner's capital item, just as he exhausts the underground deposits in hoisting ore to the surface for immediate sale. No percentage deduction, in either case, is made available until the ore is sold and income derived. Until the values have been fully realized by converting ore into income, there is no reason why the dump ore should not still be considered to be ore from the mine for depletion purposes. Whether it is moved to a mill at once, or allowed to lie for a while on the dump, is clearly immaterial.

New Idria Quicksilver Mining Company v. *Commissioner, supra,*

Kennedy M. & M. Company v. *Commissioner, supra,*

Commissioner v. *Kennedy M. & M. Company, supra.*

To deprive a mine owner and his operating lessee of the percentage allowance, merely from the circumstance that the operating lessee was granted a lease only on dump ores at the mine, is to sacrifice substance to form and defeat the owner of compensation for the depletion to his wasting asset, as well as forfeiting the allowance provided for his operating lessee. Congress recognized in Sec. 23 (m) that owners would adopt various ways and means to recover and market their metallic values. It was enacted that they shall have "a reasonable allowance for depletion * * * *according to the peculiar conditions in each case,"* and further in the same section that "in case of leases the deductions shall be equitably apportioned between the lessor and lessee"; and later, in Sec. 114 (b) (4) (A), that "The allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines * * 15 per centum * * * of the gross income *from the property* during the taxable year," etc.

In *New Idria Quicksilver Mining Co.* v. *Commissioner of Internal Revenue, supra,* the court, in approving the deduction for percentage depletion to the petitioner, said, at page 921:

> "The second question for determination is whether the New Idria Quicksilver Mining Company was entitled to claim percentage depletion on income derived from mining dumps on its land. The ore in the dumps had been milled years previously, but with the improved furnacing process, it was possible to salvage some of the ore. The dumps had always been a part of the land and no depletion had ever been claimed. This court in *Commissioner of Internal Revenue* v. *Kennedy Mining & Milling Co.*, 9 Cir., 125 F. (2d) 399, 400 said that 'tailings * * * were ores. They were ores from the taxpayer's mine, just as were the newly mined ores.' The Tax Court failed to distinguish the instant case and the Kennedy case. There is no legal distinction between the rights of the successor in interest and the rights of the original owner with respect to depletion claimed. See also *Consolidated*

Chollar, Gould & Savage Mining Co. v. *Commissioner of Internal Revenue,* 9 Cir., 133 F. (2d) 440."

In *Commissioner v. Kennedy M. & M. Co.,* 9 Cir., 125 Fed. (2d) 399, 400-401, the court said:

"The Commissioner contends that only so much of the taxpayer's income as was derived from newly mined ores was income from the mine; and that, since no net income was so derived, no deduction for depletion was allowable.

"The Commissioner's contention must be rejected. The tailings from which the taxpayer derived part of its gross income and all of its net income during 1935 and 1936 were ores. They were ores from the taxpayer's mine, just as were the newly mined ores which the taxpayer treated in 1935 and 1936. Income derived from the ores called tailings, as well as that derived from the newly mined ores, was income from the mine.

"It is true, but not material, that the ores called tailings were mined prior to 1935. The mining of ores and the receipt of income therefrom are seldom, if ever, simultaneous. The two events are usually months apart and not infrequently years apart. Thus income from a mine during a taxable year may, and usually does, include income from ores mined prior to that year.

"Nor is it material that these ores (now called tailings) were, prior to 1935, subjected to treatment whereby part of their gold content was removed. The ores so treated remained after such treatment, as they were before, the property of the taxpayer and were thereafter, as theretofore, ores from the taxpayer's mine. Income derived from their subsequent treatment was income from the mine just as was that derived from their first treatment.

"It is likewise immaterial that the subsequent treatment of these ores (in 1935 and 1936) was in a cyanide mill instead of a stamp mill. The right to deduct

for depletion of a mine a percentage of the gross or net income therefrom does not depend upon the type of mill used in treating the ores from which such income was derived. Nor is the taxpayer's right to the deductions here claimed affected by the fact that, prior to 1934, it claimed and was allowed deductions for 'unit' depletion in accordance with Revenue Acts then in effect. *Commissioner* v. *Elliott Petroleum Corp.*, 9. Cir., 82 F. (2d) 193.

"Atlas Mining Co. v. Jones, 10 Cir., 115 F. (2d) 61, cited by the Commissioner, is not in point. The taxpayer in that case was a contractor which had contracted with the owner of a tailings dump to treat the tailings therein for a share of the proceeds. *Neither party to the contract owned any mine.* The court held, and rightly so, that income resulting from performance of the contract was not income from a mine.

"Decision affirmed."

In *Kennedy M. & M. Co.* v. *Commissioner*, 43 B.T.A. 617, which was affirmed in the case just quoted, the Board of Tax Appeals said:

"And it is recognized by both parties that the mere extraction and actual depletion of mineral property does not either entitle the owner to depletion at that time nor prevent him from benefiting by it later when the ultimate step—recovery of income from the property—is taken. *Inspiration Consolidated Copper Co.*, 11 BTA1425; *National Petroleum & Refining Co.*, 28 BTA 569. It seems to us necessarily to follow that this would be so whether the process of extraction were completed but the product resulting remained undisposed of until later years; or, as occurred in petitioner's case, the process of extraction fell into two steps, was partially completed and brought about partial sales in one year, and the postponed and refined process of extraction made possible further sales in a subsequent year. * * *

"Nor is it of any greater consequence that some of the tailings may have been the residue of ores removed from the mine at a time when no percentage depletion was allowable to petitioner. For the time of receipt of the income determines not only the year for which percentage depletion is to be deducted, but the currently applicable law which is to be invoked. *Crews* v. *Commissioner* (C.C.A., 10th Cir.), 89 Fed. (2d) 412 (37-1 USTC 9196); *National Petroleum & Refining Co., Supra.* * * *

"For reasons which will now appear to be obvious, cases cited by respondent are inapplicable. In *Atlas Mining Co.* v. *Jones* (C.C.A., 10th Cir.), 115 Fed. (2d) 61 (40-2 USTC 9711), both the District Court, 29 Fed. Supp. 942 (39-2 USTC 9739), and the Circuit Court of Appeals emphasized tnat they did not purport to pass upon a situation where the tailings deposit remained the property, and the income therefrom remained the income, of the owner of the mine from which they had originally been extracted. Granting that a tailings deposit is not a mine as the court there held, it does not follow, of course, that its contents are not the product of the mining property, that minerals extracted therefrom did not have their origin in the mine, or, as respondent argues, that income from the sale of such minerals when ultimately recovered is not income from the mining property. See also *Carl M. Britt*, 43 BTA 254 (Jan. 7, 1941)."

Far from militating against the taxpayer at bar, as considered in the opinions below, the Ninth Circuit case of *Consolidated Chollar, Gould & Savage Mining Co.*, 133 F. (2d) 440, sustains our contention, because the facts were the converse of the situation at bar and in the *New Idria* and *Kennedy* cases. In *Consolidated Chollar*, the deduction for percentage depletion was denied because *the rock and ore dumps were created "from mines not located on such lands,* many years prior to the acquisition of such lands by the petitioner."

The court, at page 441 said:

"Petitioner contends that the deduction is warranted by our decision in Commissioner v. Kennedy Mining and Milling Co., 9 Cir., 125 Fed. (2d) 399. We do not agree. There we held the depletion deduction allowable because the recovery of mineral was from tailings of partially worked ore from a mine and mill owned by a taxpayer, deposited on taxpayer's land adjacent to the mine and mill from which they came, and hence the recovery was a mere continuation and completion of the processing of mineral extraction begun in the removal of the deposited material from the mine to the tailing dump."

The adverse opinions below also quote from *South Utah Mines & Smelters* v. *Beaver County,* 262 U.S. 325, 332, 43 S. Ct. 577, 579, 67 L. Ed. 1004, 1008, as follows (R.19):

"The tailings severed and removed from the mining claims, changed in character, placed on other and separate lands and having an ascertained and adjudicated value of their own, in our opinion, constituted a unit of property entirely apart from the mine from which they have been taken. See *Forbes* v. *Gracey,* 94 U. S. 762, 765."

This language is taken out of context in a case wholly unlike the facts and controversy at bar. The case concerned county taxes upon mining property, and the question of depletion was not involved. The Utah constitution provided that all property should be taxed in proportion to its value, and an amendment provided that mines should, in addition to an arbitrary valuation of $5 per acre, be assessed "at a value based on some multiple or submultiple of the net annual proceeds thereof." The legislature enacted a statute in pursuance of this amendment providing for assessment, in addition to the $5 per acre, upon a value to be determined by taking the multiple of three times the net annual proceeds thereof. The plaintiff mining corporation owned wholly depleted mining claims and also a concentrating mill which was obsolete and largely dismantled.

The mine itself was worked-out and worthless. Near the mill and about three miles away from the mine, the plaintiff had an accumulation of tailings, and made an agreement with the Utah Leasing Company for the treatment and reduction of this deposit upon a ten per cent royalty. In 1918 the leasing company recovered the net sum of $120,547.00 from the tailings, paying 10% to the plaintiff. The county taxing officials then multiplied this net sum recovered by three, and assessed the value of the plaintiff's *mine* for 1919 at $361,641.00, an obviously unfair conclusion.

From the opinion:

> "As a result of the concentrating operations refuse material, still retaining small quantities of copper and other metals, was deposited near the concentrating mill as tailings. This deposit was begun by plaintiff's predecessor as early as May, 1903, and from then until August, 1914, approximately 900,000 tons of tailings were accumulated upon desert land owned by plaintiff, nonmineral in character, and located about 3 miles from its mining claims."

The injustice of the assessment so made by the county caused this Court to say, on page 331:

> "The net proceeds here involved arose from a lot of refuse material, which, long prior to the imposition of the tax, had been severed from the mining claims, removed to a distance, submitted to the process of reduction, and stored upon lands separate and apart from the claims. Moreover, but one tenth of the amount of these net proceeds was realized by the owner of the mining claims. To treble the total of these proceeds for the purpose of basing thereon an altogether fictitious value for a mine worked out and worthless years before the adoption of the statutory provisions supposed to confer the authority to do so results in such flagrant and palpable injustice as would cast the most serious doubt upon the constitutionality of such provisions if thus construed. * * *

But the difference between a mine from which ore is being or still may be extracted and net income derived, and one conceded to be an empty shell, with no present or prospective value whatsoever, is so obvious that the imposition of a tax upon the basis of their being, nevertheless, one and the same, cannot be sustained with due regard to either law or logic."

This Court then carefully pointed out that it was not deciding or considering the measure of value of a mine which included dumps and tailings placed and remaining upon the mining claims or connected with a going mine, and said:

"How far the state statute defining the net annual proceeds to be considered in measuring the value of a mine properly includes those derived from dumps and tailings placed and remaining upon the mining claims or connected with a going mine, we do not determine; but we do hold that the proceeds from the tailings in question, under the facts here disclosed, are not included within its terms. The court below should have so construed the statute and rendered judgment for the plaintiff."

The facts and the reasoning of this Court therefore emphasize the error of relying on them in the decision against the taxpayer at bar in the court below, because of the opposite situation here presented.

The principle here at stake was missed entirely by the lower court when it argued that the dump itself is not a "mine" or a "natural deposit", a contention never advanced by the petitioner. The simple point is that the dump ores came from the mine and depleted the mine, and were merely in delayed transit to mill and market. Ores after extraction usually pause somewhere, often for a long time, either in underground stopes, in a dump on the surface near the collar of a shaft or the mouth of a tunnel, or in ore-bins near the mine or at a railroad siding, or at a mill or smelter awaiting treatment. If they never move on to the final step of treatment and sale, there is no legal

depletion of the mine affording a percentage deduction, because the measurement of the depletion never takes place. But the period of delay before sale and consequent income is immaterial. It is not the dump that has been depleted, nor the underground stope-fill, nor the ore-bin; it is the mine and natural deposit underground that has experienced depletion, the legal measure of which is only determined when a money income is derived from sales. This principle is clearly understood and applied in the Ninth Circuit cases.

In the sense dissociated from the special percentage depletion provisions of the revenue law, Sec. 114 (b) (4), depletion of the vein does of course occur at the time the ores are extracted from it, but the taxpayer here had elected to take percentage depletion, hence the amount of such depletion could not be ascertained until the ores were sold and income derived.

III.

If this Court were to conclude that an ordinary unrelated lessee of a mine-owner cannot have the percentage deduction where its lease included only the dump, still the deduction should nevertheless be allowed here "according to the peculiar conditions", under Sec. 23 (m), because of the essential unity of the mine-owner London Extension and its nominal lessee.

The facts stipulated (R. 48) are that "Chicago Mines Company, a wholly owned subsidiary corporation of the petitioner, entered into a lease from petitioner on June 10, 1940, under which Chicago Mines Company proceeded to mill that part of the American dump which could be sorted and milled at a profit until October 8, 1940, when Chicago Mines Company was dissolved"; and that (R. 8) "The corporate life of Chicago Co. expired October 8, 1942, and all its assets previously were transferred to its parent company London Co. (London Extension) and the capital stock held by said parent company and the qualifying shares held by its directors were at that time cancelled and surrendered." And at R. 7: "Chicago Co. was

a wholly owned subsidiary of The London Extension Mining Company, petitioner * * *". The paper styled a Lease Contract (R. 4-5), wherein the parent company and mine-owner held all of the stock, and the qualifying shares were held by its directors, was signed by the same persons respectively vice-president and secretary of the nominal lessor, and president and secretary of the nominal lessee. It is obvious that Chicago Mines was a mere department for the mine-owner, and that the nominal lessor was and is the real and only party in interest in the transaction involving metals from its mine.

This court has held that under such circumstances the corporate entities are to be disregarded where a legislative policy to encourage a particular activity is advanced. Mr. Justice Reed, speaking for this court in *Moline Properties Inc.* v *Commissioner of Internal Revenue,* 319 U.S. 436, 63 S. Ct. 1132, 87 L. Ed. 499, at 1503, said:

> "A particular legislative purpose, such as the development of the merchant marine, whatever the corporate device for ownership, may call for the disregarding of the separate entity. *Munson S. S. Line* v. *Commissioner of Internal Revenue* (CCA 2d), 77 F. (2d) 849."

Here the "particular legislative purpose" is that the owner of the depleted mine can take his capital depletion in a policy of encouraging production of mineral supplies. The short supply of metals presents a national need comparable to the need for merchant ships.

In the decision above cited and followed by this Court, *Munson S. S. Line* v. *Commissioner of Internal Revenue,* (CCA 2d), 77 Fed. (2d) 849, the court discusses this principle at length, at pages 850-1, from which we quote:

> "The declared purpose of the Merchant Marine Act of 1920 was to encourage the development and maintenance of an American merchant marine. 46 USCA Sec. 861. Pursuant to that purpose section 23 (46 USCA, Sec. 878) offered to the 'owner' of a vessel

documented in the United States and operated in foreign trade, as an inducement to invest the earnings in additional ships, the allowance of a deduction for the computation of war-profits and excess-profits taxes. The present dispute concerns the meaning of the word 'owner' as used in this section. Construed narrowly, as the Commissioner contends it should be, only the subsidiary corporations may be deemed the owners of the vessels respectively documented in their names. Construed broadly, the petitioner may be deemed the owner of the subsidiaries' vessels because of its stock ownership of the subsidiaries and its exercise of dominion over them and their property. That the word 'owner' may be given a broad interpretation in order to carry out the legislative purpose is well illustrated by *Flink* v. *Paladini*, 279 U.S. 59, 49 S. Ct. 255, 73 L. Ed. 613, where stockholders of a corporation which owned a vessel were held to be within the act limiting the liability of shipowners (46 USCA Sec. 183) in order to save them from the rigors of a California statute which made stockholders liable for corporate obligations. The opinion by Mr. Justice Holmes states the rationale of the decision as follows:

> " 'The purpose of the act of Congress was "to encourage investment by exempting the investor from loss in excess of the fund he is willing to risk in the enterprise." * * * For this purpose no rational distinction can be taken between several persons owning shares in a vessel directly and making the same division by putting the title in a corporation and distributing the corporate stock. The policy of the statutes must extend equally to both. In common speech the stockholders would be called owners, recognizing that their pecuniary interest did not differ substantially from those who held shares in the ship. We are of opinion that the words of the acts must be taken in a broad and popular sense in order not to defeat the manifest intent.'

"Similarly, in *Olds & Whipple, Inc.* v. *Com'r.*, 75 F. (2d) 272, this court interpreted broadly the phrase 'owned by the same interests' and held that a corporation and its stockholders were the same interests for purposes of the statute relating to affiliation.

"The petitioner's argument that the broad construction for which it contends is more consonant with the purpose of promoting investment in new American ships seems to us well taken. No reason is apparent, or has been suggested, why Congress should wish to limit its encouragement to corporate shipowners whose vessels were held directly and to exclude a corporation which operated through wholly-owned subsidiaries. Indeed, to treat the parent corporation as owner of the vessels operated through subsidiaries would serve the purpose of the statute better than would a literal interpretation which confines 'owner' to the holder of legal title. A corporation operating a single vessel is likely to have to accumulate its earnings over a considerable period before they will suffice to build an additional vessel. The necessary surplus for such investment will be more quickly obtained by a company operating several vessels. This will be equally true whether the operating company has legal title to the vessels or is a holding company operating them through wholly-owned subsidiaries. Hence it would tend to produce a greater investment of earnings in new ships to offer to such parent corporation the encouragement of the deduction allowed by section 23 to vessel owners. An interpretation reaching this result should be adopted if the words used will permit of it. We think they will.

"* * * * * * Thus even in tax cases the separate identity of corporations may be disregarded in exceptional circumstances. See, also, *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133; *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442, 54 S. Ct. 788, 78 L. Ed. 1348. In our opinion to disregard it under the circumstances here disclosed will

better carry out the legislative purpose of the statute in question. Accordingly we hold that the petitioner should be deemed the owner of the subsidiaries' vessels within the meaning of section 23."

As said by Circuit Judge Bratton in *Inland Co.* v. *Commissioner,* 120 Fed. (2d) 986, on page 988:

"But it is equally well settled that extraordinary circumstances sometimes exact the disregard of such separateness of entity in the solution of problems relating to taxes. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 37 S. Ct. 540, 62 L. Ed. 1142; *Gulf Oil Corporation* v. *Lewellyn,* 248 U.S. 71, 39 S. Ct. 35, 63 L. Ed. 133; *Burnett* v. *Commonwealth Improvement Co.* supra; *Gregory* v. *Helvering,* 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596, 97 A.L.R. 1355; *Griffiths* v. *Commissioner,* 308 U.S. 355, 60 S. Ct. 277, 84 L. Ed. 319; *Higgins* v. *Smith,* 308 U.S. 473, 60 S. Ct. 355, 84 L. Ed. 406; *Continental Oil Co.* v. *Jones,* supra. * * * That separateness is disregarded where the ownership of stock is used to dominate and control the subsidiary in such manner and to such extent that it becomes a mere agency or instrumentality of the parent. *United States* v. *Lehigh Valley R. R. Co.* 220 U. S. 257, 31 S. Ct. 387, 55 L. Ed. 458; *U.S.* v. *Delaware, Lackawanna & Western R. R. Co.,* 238 U.S. 516, 35 S. Ct. 873, 59 L. Ed. 1438; *Chicago M. & St. Paul Ry. Co.* v. *Minneapolis Civic Assn.,* 247 U. S. 490, 38 S. Ct. 553, 62 L. Ed. 1229; *United States* v. *Reading Co.,* 253 U. S. 26, 40 S. Ct. 425, 64 L. Ed. 760; * * *

"* * * But whatsoever the underlying reason may have been, it is clear that the subsidiaries were nothing more than voiceless departments or instrumentalities of the taxpayer. Substance is paramount over form in the application of income tax laws. *United States* v. *Phellis,* 257 U.S. 156, 42 S. Ct. 63, 66 L. Ed. 180; *Tulsa Tribune Co.* v. *Commissioner of Internal Revenue,* 10 Circ., 58 F. (2d) 937; *Reynolds* v. *Cooper,* 10 Cir., 64 F. (2d) 644, affirmed, 291 U. S. 192, 54 S. Ct. 336, 78 L. Ed. 725; *North Jersey Title Insurance*

Co. v. *Commissioner of Internal Revenue,* 3 Cir., 84 F. (2) 898; *Commissioner of Internal Revenue* v. *Texas Pipe Line Co.,* 3 Cir. 87 F. (2d) 662. * * *"

At bar it seems a "distinction without a difference" whether Mr. Bishop was president of both companies, instead of president of one and secretary of the other, and Dr. Fraser secretary of both, or whether they used the same or a different stenographer and bookkeeper, or foreman and superintendent, so long as London Extension owned Chicago Mines and all its assets, "lock, stock and barrel," until its dissolution (Stip., pars. 1 and 6, R. 7 and 8; Ex. B, R. 5), all ownership being exclusive in London Extension and each dollar being by way of gain or expense to London Extension, owner and transferee. "He who does anything through another is doing it himself." Whether they may or may not have used a different agent in any connection appears trivial and irrelevant, since agency does not affect the status of the principal or the substance involved in unity of ownership, London Extension owning and holding 100% of Chicago Mines stock. The equities in the taxpayers' situation at bar should bring it within the exceptions, for Sec. 23 (m) itself says that deductions "shall be allowed * * * according to the peculiar conditions in each case." The Congressional purpose is to encourage output of metal.

IV.

We also ask a review and reversal of new judicial restrictions limiting a right to depletion deductions, announced in the opinion below. These violate principles of depletion intended by Sections 23 (m) and 114, and previously announced by the Ninth Circuit and by the Board of Tax Appeals in the *New Idria* and *Kennedy* opinions. The proposed new barriers would deny the deduction unless the taxpayer marketing ores from his mine dump could show an accompanying intent to work the dump at a future time, at the time the dump ores were deposited on the property (R. 64, 66), and would further prescribe that the working of the dump must be "an integrated step in the original mining operation" (R. 66, 65), or "an

integrated part of the original mining operation" (R. 64). Such restrictions would disregard the fact and theory of depletion. They would also impose oppressive difficulties of proof, and create needless disputes and injustices, often eliminating any real chance of a just allowance for depleted capital assets.

It is characteristic of mine dumps, especially rather old ones, that they are the composite product of a series of operations by various prior owners, lessees and optionees, by whose efforts they were built up in successive layers over the years. In a correct view of depletion, details of prior ownership and leases are utterly immaterial. They do not affect the merits at bar, or in any case of the typical dump at a mine. This is true because of the great essential of depletion in the mine and the legislative policy recognizing the underlying fact of depleted capital. The mine has been neither more nor less depleted by the extraction of ore, from the fact that several various lessees operating under the owner, and various owners operating themselves, may have done the work and built up the dump, with no doubt a wide variety of hopes, plans and opinions about the future. The proposed new restrictions would unfairly defeat the allowance in most cases, for the reason that if the dump is created by a lessee and he does nothing with it, the owner will not be able to establish an "accompanying intent", since the lessee when he gave up the lease, leaving the dump, had no intention of later recovering the values, however rich the later improved processes, or increased prices, or better operating labor or facilities, may cause them to become. If part of the dump were created by a former owner, part by former lessees, part by the present owner, and part by his later lessees (which would be a typical case), with the former owners and lessees dead or gone, it would not be possible for the mine owner to establish an accompanying intent as to layers of the dump (which practically never is worked in layers, but in perpendicular blocks), and he would be denied depletion of the mine and natural deposits, notwithstanding the fact that the statutory percentage becomes determinable from income as he sells the dump ores.

The further proposed bar to the allowance, requiring a mine owner to show that his dump ore was worked and marketed "as an integrated part of the original mining operation" (R. 64, 66), is also untenable. It is not sustained by the statute, is against the decisions cited herein, and does not accord with the necessities of mining. The phrase is likewise vague in its meaning and implications. We submit that the only material integration is that which exists from the origin of the dump ore in the underground veins, to measure the depletion thereof when sold; and there is thus an integrated chain or flow from the owner's natural deposit into his pocket or bank account, from which the statutory depletion of the deposit is computed.

To avoid repetition we respectfully refer the Court to the more detailed discussion, giving practical examples on this subject, in the memorandum by *amici curiae* representing The Colorado Mining Association (R. 83-97) in support of the petition for rehearing.

Also, to avoid repeating a lengthy review of the *Kirby*, *Douglas* and *Herring* decisions of this Court, we refer to the other brief by friends of the court filed below (R. 101-124).

CONCLUSION.

We therefore ask that the decisions below be reviewed and reversed.

Respectfully submitted,

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APPENDIX

STATUTORY PROVISIONS

The statutory provisions involved are found in paragraph (m) of Sec. 23, and paragraph (b), sub-paragraphs (4) (A) and (B) of Sec. 114 of the Internal Revenue Code, Title 26 U.S.C.A. Sub-paragraph (4) (B) of paragraph (b) of Sec. 114 was added by Sec. 124 (c) of the Revenue Act of 1943, and is as effective as through it were in the revenue laws applicable to all taxable years beginning after December 31, 1931.

Section 23, in force for the taxable periods here involved, insofar as pertinent, is as follows:

"Section 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions: * * *

"(m) Depletion. In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowances in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *."

Section 114, in force for the taxable periods here involved, insofar as pertinent, is as follows:

"Section 114. Basis for Depreciation and Depletion. (b) Basis for Depletion.—(4) Percentage Depletion for * * * Metal Mines * * *.

"(A) In general. The allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines, * * * 15 per centum * * * of the gross income from the property during the taxable year, excluding from

such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *."

Section 114 (b) (4) (B), as added by Section 124 (c) of the Revenue Act of 1943, effective as though it had been in the revenue laws applicable to all taxable years beginning after December 31, 1931, so far as pertinent, is as follows:

"(4) (B). Definition of Gross Income from property. As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: * * *; and (iv) in case of lead, zinc, copper, gold, silver or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."

REGULATIONS 103.

Treasury Regulations 103, so far as appears applicable here, is as follows:

"Sec. 19.23 (m)--1 (as amended by T. D. 5210, Jan. 8, 1943). Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvement.—

"Sec. 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

"Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a constructual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest."